Minutes of the Meeting of JGB Market Special Participants
(97th Round)

1. Date: Friday, December 10, 2021
2. Place: Held in writing
3. Gist of Proceedings:

1. Issuance size of Inflation-Indexed Bonds in the January-March 2022 quarter

▶ The Financial Bureau gave the following explanation about the issuance size of Inflation-Indexed Bonds in the January-March 2022 quarter.

・ As shown on page 3, according to the JGB Issuance Plan for FY2021, it is stipulated that there will be issuance of Inflation-Indexed Bonds four times a year for the size of ¥200 billion per each time while stating that "the issuance size may be adjusted in a flexible manner in response to market circumstances and demands of investors which will be determined based on discussions with market participants." In addition, as shown on page 4, it is stipulated about Buy-back Auctions that "Buy-back Auctions in FY2021 is planned to be implemented based on market conditions and through discussions with market participants.". Today, we would like to hear your opinions about the issuance size in the January-March 2022 quarter.

・ In the October-December quarter, as shown on page 5, we conducted an auction of issuance for ¥200 billion in November and conducted Buy-back Auctions for the amount of ¥50 billion every month by considering market circumstances and exchanging opinion with market participants. The results of the issuance by auctions and Buy-back Auctions are shown on pages 6 and 7.

・ The situation of the secondary market is shown on pages 8 and 9. According to the changes in the past half year, the BEI of each country has risen with some fluctuations against the backdrop of the increase in crude oil prices and worldwide prices, and the BEI of Japan has made a similar movement. In addition, although there are large variations continuously depending on issues, the BEI has risen in almost all issues.

・ In the circumstances, we asked for your opinions in advance. Many participants expressed the views that the amount of Buy-back Auctions should be decreased without changing the issuance size due not only to the fact that the BEI remains steady and strong with some fluctuations while the price increase is becoming the topic in the overall financial market, but also to the fact that the supply-demand balance is very strong according to the results of issuance auctions, Buy-back Auctions and Outright Purchase of JGBs.

・ On the other hand, some participants expressed the view that although the supply-demand balance has been improving, measures to nip the improvement in the bud should be avoided yet, and that since there is doubt about the continuity of price rises in Japan, it is desirable that the both the issuance size and the amount of Buy-back Auctions are left unchanged.

・ In addition, a small fraction of participants expressed the view that since the results of the auctions are strong, it is desirable that the issuance size is increased while leaving the amount of Buy-back Auctions unchanged.

・ We believe that the development of the Inflation-Indexed Bonds market is an important issue in Debt Management Policy and since the current issuance size and the amount of Buy-back Auctions are the results of extraordinary and temporary measures in the wake of the significant market deterioration caused by the spread of the infections of the COVID-19, we consider it undesirable that the current situation is normalized. In line with these ideas, we conveyed the idea in the meeting in September that we would conduct an in-depth examination on the amounts of issuance in the January-March 2022 quarter for normalization from these measures.

・ In light of this background and your opinions, our proposal is shown on page 10. We are considering conducting an auction of issuance for the amount of ¥200 billion in the January-March 2022 quarter in the same manner as in the October‐December 2021 quarter. Regarding the amount of Buy-back Auctions, we are considering conducting a Buy-back Auction in the amount of ¥20 billion every month by reducing the amount from the October–December 2021 quarter. Provided, however, that if the market environment deteriorates significantly during the quarter, we will take measures such as flexibly increasing the offer amount for Buy-back Auctions.

・ As above, we explained the situation regarding the Inflation-Indexed Bonds market and our proposal in consideration thereof.

Since we will make a comprehensive decision based on the contents of today's meeting on the issuance size in the January-March 2022 quarter, we will hear your opinions again.

Incidentally, we recognize that, when considering that we conducted Buy-back Auctions in an amount of ¥20 billion every other month until the July-September 2019 quarter, the idea proposed on this occasion is still on the way to normalization. We will conduct a further in-depth review for normalization also in the April-June 2022 quarter and beyond. At that time, we will carefully take into consideration the status of auctions, the market situation and your opinions before taking any decision.

▶ Summarized below are the views and opinions submitted:

・ As the debt management office referred to the normalization from the extraordinary and temporary measures already in the meeting in September, we agree to the proposal of the debt management office to leave the issuance size of ¥200 billion unchanged and reduce the amount of Buy-back Auctions to ¥20 billion every month.

・ Not only the result of the Buy-back Auctions conducted most recently (December 3rd) was strong, but also the result of the auctions conducted in November was strong. Therefore, the tightening of the supply-demand balance has become remarkable recently. When considering that concerns over the uncertainties of supply and demand triggered by the COVID-19 pandemic are almost behind us, we agree to the proposal of the debt management office to reduce the amount of Buy-back Auctions and leave the issuance size of new bonds unchanged.

・ We are not uncomfortable with the direction of normalization from the extraordinary measures taken recently.

However, since investors are gradually returning and the number of investors has just started to increase due to the improvement of the market environment thanks to the purchase by the debt management office and the Bank of Japan (BOJ), we would like to ask the debt management office to continue to take careful steps flexibly for the normalization by maintaining dialogue with the market from the perspective of the sound development of the market.

・ An improvement in the supply-demand balance is observed in the market of Inflation-Indexed Bonds as a result of cumulative effects of the reduction in the issuance size and the increase in the amount of Buy-back Auctions by the debt management office. It seems that investors' demand has improved due to the knock-on-effects of the global inflation on Japan. We deem that the inventory situation of the market is low as seen in the results of the most recent Outright Purchase of JGBs and Buy-back Auctions of the debt management office. Therefore, we agree to the proposal of the debt management office to reduce ¥30 billion monthly. Moreover, since there is a possibility that the number of investors will gradually increase in the future, we consider that if this actually occurs, it is necessary to consider increasing the issuance size.

・ It is seen that the supply-demand balance has been improving in light of the strong results of the most recent auctions and the results of Buy-back Auctions and Outright Purchase of JGBs, which reflect the actual situation. On the other hand, the supply-demand balance of a part of already-issued bonds is tight because of abundant Buy-back Auctions and Outright Purchase of JGBs. We agree to the proposal of the debt management office to adjust the supply-demand balance which is currently in the considerable excess of absorption with the reduction in the amount of Buy-back Auctions because of the improvement tendency of supply and demand.

・The supply-demand balance of Inflation-Indexed Bonds has improved remarkably by the continuous Buy-back Auctions and Outright Purchase of JGBs of the debt management office and the BOJ. In view of the BEI level and the strong results of the most recent auctions and Buy-back Auctions, we believe it possible that the amount of Buy-back Auctions be reduced to ¥20 billion per month which is the same level as that before the outbreak of COVID-19. We believe it desirable that the adjustment of the supply-demand balance at this stage is made with Buy-back Auctions from the viewpoint of mobility. We believe it necessary to consider normalizing the issuance size depending upon the situation in the future as well.

・ The auctions of Inflation-Indexed Bonds in November were very strong and the BEI thereafter is also strong. It seems highly probable that some investors hedge the inflation risk with JGBs. On the other hand, however, many investors do not consider that the prices in Japan will continue to rise and it will take more time to see whether or not the current strong supply-demand balance will continue. Therefore, we request that the issuance size is left unchanged and the buy-back amount is carefully reduced in the January-March quarter.

・ We agree to the proposal of the debt management office.

・ Owing to the underlying global inflation, many investors have participated in the market of Inflation-Indexed Bonds in Japan. If the participation of a wide variety of investors both Japanese and foreign continues from the next year onwards as well, we think we should consider reverting the issuance size per auction which was reduced as a temporary measure in COVID-19 pandemic to ¥300 billion appropriately.

・ We support the amount reduction and the policy of the normalization.

If the prices continue steady and strong, we request the debt management office to clarify whether the goal of the normalization is the bimonthly Buy-back Auctions of ¥20 billion or Buy-back Auctions are ideally completely stopped in the same manner as with fixed-rate couponbearing bonds.

・ Although we seem to have heard the opinion before that the issuance size would be increased before stopping Buy-back Auctions, we believe that the market will be expanded if the issuance size is increased while maintaining Buy-back Auctions. If Buy-back Auctions continue to be maintained by reducing the amount, we consider it appropriate that the current issuance size is maintained. We think that the opinions of the top bidders should be given priority.

・ When compared to nominal bonds, Inflation-Indexed Bonds continue strong supported by concerns over inflation overseas. However, we are of the view that when compared to overseas, they continue to be comparatively cheap. In addition, liquidity continues to be weak. In the secondary market, prices are formed without hardly any trading and it seems that the supply demand gap continues to remain between current issues and off-the-run issues with a large issuance volume. Although the last auctions were strong, we have the impression that a part of investors continue to form the market. Therefore, we believe it will take more time for broadening the base of investors. Since the underlying market improvement may be hampered if the balance of the issuance and buy-back is changed under the current situation, we support the current issuance size (¥200 billion per auction) and the buy-back amount (¥50 billion per auction) in the January-March quarter.

・ We believe it important to eventually increase the issuance size for normalization. However, if the amount is increased, at least, an increase of ¥100 billion per auction will be assumed and its impact will be large. According to the content of the proposal of the debt management office, a decrease in the buy-back amount in a quarter will be ¥90 billion. We believe that although the cumulative impact is not largely different, the degree of impact on each auction may be mitigated.

・ The inflation index of the US and Europe shows a growth of over 2%. Although the inflationary pressure on consumer prices is limited at the current stage in Japan, since corporate good prices have been increasing significantly, there is a growing sense of hope for price rises in Japan. We consider the very strong results of the auctions of Inflation-Indexed Bonds conducted in November as the evidence thereof. Although there is still a sense of uncertainty about the future, we believe it possible to proceed to the normalization step from the current extraordinary and temporary measures.

・ We agree to the proposal of the debt management office. When considering that the BEI continues to be strong and the strong results of the issuance auctions and Buy-back Auctions conducted most recently, we believe that there is room for reducing the amount of Buy-back Auctions increased as a temporary measure.

・ There is no denying that the size of Buy-back Auctions relative to the issuance size impaired liquidity. Therefore, we agree to the proposal to leave the issuance size of ¥200 billion unchanged and reduce the amount of Buy-back Auctions to ¥20 billion per auction. The reasons are that the difference between the average winning bid and the lowest winning bid was large in the preceding Buy-back Auctions and the price fluctuations become large due to an increase in inquiries from investors against the backdrop of global price rises.

・ We agree to the proposal of the debt management office.

・ Although the BEI fluctuates upside down somewhat most recently, the improvement continues. Therefore, we support the idea of reducing the amount of Buy-back Auctions which is large relative to the issuance size.

・ Under the current market environment, we consider it appropriate to reduce the purchase amount per auction to ¥20 billion as proposed by the debt management office.

2. Issuance size of Liquidity Enhancement Auctions in the January-March quarter 2022

▶ The Financial Bureau gave the following explanation about the amount of Liquidity Enhancement Auctions in the January-March 2022 quarter.

・ As shown on page 12, according to the FY2021 JGB Issuance Plan regarding Liquidity Enhancement Auctions,

(1) while it is assumed that JGBs in a total of ¥11.4 trillion will be issued in a year, including ¥2.4 trillion with a remaining maturity of 1 to 5 years, ¥6.0 trillion with a remaining maturity of 5 to 15.5 years and ¥3.0 trillion with a remaining maturity of 15.5 to 39 years in the same manner as in FY2020,

(2) finally, “the details will be flexibly adjusted in view of the market environment and investment needs”.

Today, in response to this plan, we would like to hear your opinions regarding the issuance size for each maturity zone for the January-March quarter, 2022.

・ As shown on page 13, we issued bonds with a remaining maturity of 1 to 5 years in the amount of ¥400 billion in the odd-numbered month of November, bonds with a remaining maturity of 5 to 15.5 years in the amount of ¥500 billion every month and bonds with a remaining maturity of 15.5 to 39 years in the amount of ¥500 billion in the even numbered months of October and December in the October-December quarter. These results are shown on Pages 14 - 16.

・ In the circumstances, we asked your opinions about the Liquidity Enhancement Auctions for the January-March 2022 quarter in advance, and some members requested an increase in the amount of bonds with a remaining maturity, in particular, of 1 to 5 years due to the tightening of supply and demand conditions. However, since there is no such significant change in the supply and demand situation that requires the balance of the distribution of issuance sizes among issues to be changed despite that not only the demand for bonds with a remaining maturity of 1 to 5 years, but also for JGBs in all zones is strong, we found that many of you were of the opinion that it was appropriate to maintain the current issuance size.

・ In response to this, we prepared our draft for the issue amount for each maturity zone in the January-March 2022 quarter, as shown on page 17. We are contemplating the idea of issuing JGBs with remaining maturities of 1 to 5 years in the amount of ¥400 billion in the odd-numbered months of January and March, bonds with a remaining maturity of 5 to 15.5 years in the amount of ¥500 billion every month and bonds with a remaining maturity of 15.5 to 39 years in the amount of ¥500 billion in the even-numbered month of February.

・ Regarding the issuance size for each maturity zone for Liquidity Enhancement Auctions for the January-March 2022 quarter, we will make a comprehensive decision based on the contents of today’s meeting, and we will ask your opinions again.

▶ Summarized below are the views and opinions submitted:

・ Since the demand for off-the-run issues in all three segments continues to be strong, we wish that the current status quo is maintained. If there is room for an amount increase, we wish an increase in bonds with a remaining maturity of 1 to 5 years.

・ We support the proposal of the debt management office in all maturities. Although the demand for bonds with a remaining maturity of 1 to 5 years of Liquidity Enhancement Auctions continues to be strong as shown in the most recent auction results, we are of the view that the strength does not call for a change in the issuance plan.

・ We wish that the current status quo is maintained due to the strong investors’ demand and needs to cover short-covering needs by securities companies. In particular, since the yield curve of bonds with a remaining maturity of 1 to 5 years is distorted frequently due to supply-demand balance, we believe that there is room for an amount increase.

・ Since some issues of bonds with a remaining maturity of 1 to 5 years are constantly tight in supply-demand balance, we consider that their issuance size needs to be increased to meet investors’ demand and to develop the market. Specifically, we believe it appropriate to increase the current bimonthly amount of ¥400 billion to bimonthly amount of ¥500 billion.

・ As the total annual issuance size of this fiscal year has already been determined, we support the proposal to maintain the status quo of the debt management office without changing the amount of each segment. However, from the perspective of ensuring the liquidity of the JGB market, we believe it necessary to increase the amount of Liquidity Enhancement Auctions significantly in the next fiscal year.

・ From the perspective of smooth market making, we request the amount of bonds with a remaining maturity of 1 to 5 years of Liquidity Enhancement Auctions to be increased. Further, we wish that the amount of 40-Year Bonds is left unchanged and the amount of bonds with a remaining maturity of 15.5 to 39 years of Liquidity Enhancement Auctions is increased.

・ Although we just requested an amount increase in bonds with a remaining maturity of 1 to 5 years and a remaining maturity of 5 to 15.5 years for the issuance of the next fiscal year, we consider appropriate the current distribution when considering investors’ demand and the covering-needs of securities companies based on the annual issuance size of this fiscal year.

・ Since strong needs continue, we want that the current status quo be maintained. It seems that many participants want the issuance size to be increased. Actually, auction results tend to be strong and the opinions of top bidders should be given priority.

・ We agree to the proposal of the debt management office. Since the needs to buy bonds in all maturities at Liquidity Enhancement Auctions continue to be strong, we believe that there is no room for a change in distribution in each maturity.

・ Regarding the January-March quarter, we wish that bonds with a remaining maturity of 1 to 5 years is increased if there is any leeway in the balance because purchase by overseas investors has been strong in these recent years. However, since there is a possibility that life insurance companies may make a last-minute buying at this time of year, we would request strongly that the amount of bonds with a remaining maturity of 15.5 to 39 years is not decreased. We believe it appropriate to maintain the status quo in this quarter.

・ As there are constant needs for each zone of Liquidity Enhancement Auctions, we are of the view that there is no need for any change in the issuance size currently.

・ We agree to the proposal of the debt management office.

3. JGB Issuance Plan for FY2022

▶ The Financial Bureau gave the following explanation about a review of the current situation of the JGB Issuance Plan for FY2022, etc.

・ We will give the following explanation about a review of the current situation of the JGB Issuance Plan for FY2022.

・ The status of the review of the "breakdown of the issuance size by financing method", that is, of the amount required to be financed for each use is shown on the left side of page 19. The issuance scale of new bonds and Reconstruction Bonds will be determined in the budget compilation process and that of FILP bonds will be determined in the formulation process of the fiscal investment and loan program, respectively. At this moment, we are not in a position to say anything certain about them.

・ The amount of Refunding Bonds which account for the majority of the total JGB issuance size is estimated to be increased more than that of the initial plan of this fiscal year.

・ The status of the review of the issuance size by financing method is shown on the right side. We are still carefully reviewing the amount of JGBs "for Retail Investors" and "Bank of Japan Rollover" as well as the amount of "additional issuance at the time of auction". Based on the above, the "amount of market issuance" will be determined.

・ We summarized the opinions submitted at our meeting and the Meeting of JGB Investors held last month relating to the maturity composition of the JGB Market Issuance (Calendar Base) on pages 20 and 21.

・ Regarding ultra-long-term bonds, many participants expressed their views in favor of increasing the amount of 40-Year Bonds as having a higher priority, whereas some participants requested the current status quo to be maintained. In addition, the participants of securities companies requested the shift to monthly issuance for the sake of market making and requested the amount to be increased to ¥400 billion per auction when the issuance frequency is changed to monthly. Regarding 30-Year Bonds, while many opinions favored maintaining the status quo, there were also opinions which favored a reduction in the amount. Regarding 20-Year Bonds, opinions favoring an increase in the amount and those favoring the maintenance of the status quo were heard.

・ Regarding the medium-to-long-term zones which are under the yield curve control by the BOJ, there were opinions favoring either an increase or a reduction, and regarding 10-Year Bonds, opinions were heard that there are strong needs because of positive interest rates, while, regarding 2-Year Bonds, there were opinions that there is room for an amount reduction.

・ With respect to the short-term bonds, while many participants expressed views in support of the policy of the debt management office to reduce short-term bonds by curbing the total amount of JGBs, there were also opinions requesting the maintenance of the status quo because of collateral needs.

・ With respect to Liquidity Enhancement Auctions, many participants expressed their views in favor of increasing the issuance of bonds with a remaining maturity of 1 to 5 years due to the continuing tight supply-demand balance.

・ With respect to Inflation-Indexed Bonds, there were opinion requesting the issuance size to be increased to ¥300 billion per auction in light of the current strong BEI and opinions requesting a reduction in the amount of Buy-back Auctions before increasing the issuance size.

・ In the coming days, we will decide the specifics of the JGB Issuance Plan for FY2022 in light of the aforementioned opinions and publish it together with the budget for FY2022, as usual.

▶Summarized below are the views and opinions submitted:

・ Many companies (9 companies in total) said that they have no special opinion or that submitted the opinion that there is no change from that at the last meeting.

・ (Regarding whether or not there is room for an amount increase in 40-Year Bonds) We consider that there is a plenty of room for an amount increase in 40-Year Bonds as far as an increase in the issuance size is concerned. Since the current demand by investors is considerable, there are many cases in which the supply-demand balance becomes tight. In addition, a significant difference in liquidity is found before and after the auctions in the current bimonthly issuance, we consider it an option to shift to monthly issuance.

(Regarding whether or not there is room for an amount increase in JGBs of Liquidity Enhancement Auctions) While current bonds have been increasingly issued currently, a gap in the supply-demand balance with that of existing bonds is increasing and the liquidity of exiting bonds has decreased significantly. We would like to request an increase of ¥200 billion in the issuance size of short-term bonds of Liquidity Enhancement Auctions for which there is a strong demand by our clients from the perspective of ensuring market liquidity.

・ We consider that there is room for a certain increase in the issuance size of 40-Year Bonds as we commented at the meeting in November. On the other hand, since there is a rough match between the issuance size and investors' demand in JGBs in the other ultra-long-term zone (20-Year Bonds and 30-Year Bonds), it is desirable to maintain the current status quo. If there is room for an amount reduction, we consider that JGBs with a maturity of less than 10 years which is under control by Outright Purchase of JGBs are appropriate.

・ A variety of views and opinions on the increase in the issuance size of 40-Year Bonds have been expressed. Our company considers that the issuance size of all of 20-Year Bonds, 30-Year Bonds and 40-Year Bonds should be maintained as it is. As we commented at the last meeting, we are of the view that the shift to monthly issuance of 40-Year Bonds will be accompanied by a decrease in the issuance size of 30-year bonds and Liquidity Enhancement Auctions (bonds with a remaining maturity of 15.5 to 39 years). However, investors' demand for 30-Year Bonds and Liquidity Enhancement Auctions (bonds with a remaining maturity of 15.5 to 39 years) is considerably high. On the other hand, we are of the view that the demand for 40-Year Bonds is not as high as requiring a significant increase. Therefore, we believe it appropriate that not only the reduction in the amount of 30-Year Bonds needs to be avoided, but also the issuance size of 40-Year Bonds will be increased by ¥100 billion bimonthly to a bimonthly amount ¥700 billion if they need to be increased.

Regarding JGBs a maturity of less than 10 years, we support the amount reduction of short-term bonds. As regards medium-to-long-term bonds, we request a decrease in the amount of 2-

Year Bonds and an increase in the amount of Liquidity Enhancement Auctions (bonds with a remaining maturity of 1 to 5 years) in light of the reduction in the issuance of short-term bonds and the current supply and demand environment.

・ We see that it is possible to increase the issuance size of 40-Year Bonds to a monthly amount of ¥400 billion or bimonthly amount of ¥800 billion because of their good supply-demand balance. If there are many voices calling for the shift to monthly auction, we are not opposed to the shift. Regarding Liquidity Enhancement Auctions of bonds with a remaining maturity of 1 to 5 years, as there are still many issues with a tight supply-demand balance, we continue to request an increase in the issuance size. As the demand for off-the-run issues in the ultra-long-term zone is strong, we consider it undesirable to reduce the amount of bonds with a remaining maturity of 15.5 to 39 years of Liquidity Enhancement Auctions.

・ We request that the issuance size of 40-Year Bonds be increased as we commented at the meeting in November. We request the issuance of ¥400 billion, monthly issuance and the shift to the discriminatory price auction. In addition, as far as Liquidity Enhancement Auctions are concerned, we request an increase in the segment of bonds with a remaining maturity of 1 to 5 years, as commented earlier.

・ We were surprised at the many number of participants in favor of an increase in 40-Year Bonds at the last meeting. Since top bidders are in favor of the move, we naturally support the opinions of the top bidders. In addition, it seems also that there are many requests for an increase in both Inflation-Indexed Bonds and Liquidity Enhancement Auctions and we naturally support the opinions of top bidders.

・ We think it necessary to carefully examine the increase in the issuance size of 40-Year bonds. As pointed in the last meeting, the yield curve of the issue number 14 of current bonds has steepened even after the last meeting in bonds with a maturity of 40-years or shorter. Therefore, it seems that the flattener of the yield curve observed in November onwards was mainly led by off-the-run issues. Moreover, according a disclosure document, there is a description which suggests that a part of life insurance companies has already lengthened the term of their inventory to some extent and the lengthening speed in the next quarter will be slowed down. Therefore, we are concerned about the increase of current 40-Year Bonds on the assumption that the current demand will continue also in the next quarter. If we consider the possibility that the flattener was led by off-the-run issues, our concern will increase further. In view of these considerations, we are of the view that the issuance of current 40-Year Bonds is left unchanged and bonds with a remaining maturity of 15.5 to 39 years of Liquidity Enhancement Auctions will be increased in order to meet the current demand.

・When considering the discussions at the meeting to discuss the way of debt management of the government, we are of the view that the amount increase will be focused on ultra-long-term bonds and the amount reduction on short-to-medium-term bonds. If the increase of 40-Year Bonds is made by changing from the bimonthly ¥600 billion to monthly ¥400 billion, we assume that the increase will be easily made without decreasing the amount of other ultra-long-term bonds.

In addition, it is assumed that short-term bonds will continue to be reduced gradually to correct the shortening of the term of liabilities. However, since the needs for collaterals continue to be strong, we request the debt management office to be in communication with market participants before actually carrying out the reduction.

・ We request an amount increase in 40-Year Bonds. There are domestic investors that wish to buy 40-Year Bonds put off the purchase because they are relatively more expensive than 30-Year Bonds. If the issuance size is increased, many more investors than now will be attracted and will contribute to the development of both maturities.

If they are issued monthly, we consider it desirable that bonds with a remaining maturity of 15.5 to 39 years of Liquidity Enhancement Auctions is also issued monthly from the perspective of leveling delta shares despite tight schedule.

・ If the issuance size of 40-Year Bonds is increased, they may be issued bimonthly or monthly, but we wish that the current uniform price auction will continue to be maintained.

・ Since the large scale increase in the issuance size in July 2020, there have been many auctions in which investors were forced to be more competitive and in which tails lengthened more than expected. In view of these situations, we wish that interest-bearing bonds will be left unchanged in all maturities.

4. Latest JGB market situation and outlook in the future

▶ Summarized below are the views and opinions submitted:

・ JGBs continue to be issued in an extraordinary amount in response to COVID-19. We consider that it will be important in the future normalization process that (1) the issuance which was focused on short-term bonds will be leveled and (2) the fiscal discipline will be resolutely maintained by the issuance size.

In particular, the JGB market continues to be stable under a large scale monetary easing despite a significant increase in its issuance size. While the share of JGB holding by overseas investors increases, we would like to request the debt management office to continue to provide sound growth of the JGB market and stable investment environment in the same manner as in the past with the future termination of the monetary easing in sight.

・ Due to the spread of the Omicron variant and the acceleration of FRB’s Tapering Signal, not only the volatility of US Treasury bonds, but also the volatility of the JGB market increased. In particular, the volatility increased considerably in the futures market. However, currently, the markets both in the US and Japan are regaining calmness gradually. Although there are still concerns such as the FOMC meeting by the end of the year, the US market is expected to be steady for the present towards the end of the year. We expect also that the JGB market will be steady by the end of the year if there is no upset in the JGB Issuance Plan. However, since there are heightened uncertainties next year about all aspects including inflation, economy, monetary policy, etc., we predict that the global security market will become highly volatile.

・ The JGB Issuance Plan for FY2022 is attracting attention in the recent JGB market. Although we do not assume that the issuance size of interest-bearing bonds will greatly vary when considering the use of front-loading issuance of Refunding Bonds, there is a possibility that the volatility will undergo an unexpected rise depending on the content of the issuance plan and the future management. Therefore, we request the debt management office to continue to maintain careful coordination with the BOJ and close communication with the market so as not to impair stable JGB issuance. Regarding whether or not an increase in the issuance size is possible, we consider that although the liquidity of a part of issues and a temporary tightening of the supply-demand balance will be naturally one of the reasons, it is the most important point to consider whether or not there is a sufficient number of investors capable of holding JGBs for a long period of time. According to the recent auction results, the bid-to-cover ratio is not necessarily constantly high and we have the impression that the number of investors has not increased sufficiently. In order to consolidate the foundation of smooth fiscal management through stable JGB issuance and by curbing the financing cost in the medium-to-long term regardless of the amount of JGB purchase by the BOJ, we would like to request the debt management office to focus not only on the achievement of fiscal soundness, but also on the curbing of the issuance size of new financial resource bonds.

・ Changes in the external environment caused mainly by the monetary policies of the US and Europe, the spread of the Omicron variant and the inflationary trends are carefully observed in the recent JGB market. As there is no elevated sense of caution about an increase in interest rates on the yield of 10-year bonds as a whole under YCC and the BOJ's JGB purchase, sale-purchase transactions are completed stably in all maturities. Our outlook is that interest rates will rise moderately in the medium term in line with the normalization of the monetary policy of each country.

・ Although there is a possibility that overseas monetary policies will change significantly due to the current inflationary trends and interest rates fluctuate globally, we believe that even if domestic interest rates rise temporarily, they will not continue under the support of YCC.

・ The correlation of the JGB market with the US and European markets was very high until the end of October from summer. However, we have the impression that decoupling started to occur in the government bond market of each country from early November when the interest rate raising was put off by the BOE when the COVID-19 spread infection started to deteriorate in Europe and the degree of sensitivity to overseas market has gradually dropped.

In the wake of the report on the spread of the Omicron variant at the end of November, interest rates dropped led by the futures market and as a result of the interest rate drop, cash bonds are sold sporadically on temporary recovery. The yield curve of 5-Year Bonds and the futures cheapest-to deliver bonds was inverted and has exceeded the level at summer in which interest rates were globally low even in terms of balance among 5-Year, 7-Year and 10-Year Bonds. Therefore, there are concerns over a further decrease in liquidity towards the end of the year.

Although the yield curve flattened significantly, not only in the US Treasury market, but also in the bond markets in Europe from October, no flattener has occurred in the JGB market, which brings home again the poor supply-demand balance of ultra-long- term bonds and the decrease in the number of participants.

The current environment does not allow us to expect a change in the monetary policy for the time being. In addition, concerns over an increase in JGB issuance in response to the additional economic measures after the end of the general elections have been almost dispelled and the volume of transactions in the secondary market is decreasing with no clear direction for interest rates in sight.

Regarding the future outlook, there are few domestic factors to spur active trading and the market will continue to wait and see the US and European markets and the yield of 10-Year Bonds will fluctuate in the range of 0.05-0.10%. Although there will be a sense of caution about an increase in CPI in Japan in the next fiscal year, we are of the view that such a prospect is not a topic within this fiscal year.

・ Since the “revision” of the monetary policy by the BOJ made in March this year, some market fluctuations have been observed in line with the external environment such as overseas interest rates. On the other hand, since the large scale increase in JBG issuance in July last year, the gap of the supply-demand balance between current bonds and off-the-run bonds, bonds before amount increase and bonds after amount increase has widened in some issues and maturities, we have the impression that it is necessary to provide a balance between issuances, such as reducing the issuance of new bonds, increasing the issuance of Liquidity Enhancement Auctions, etc., in the future.

・ Since the domestic prices are stable and the view that the current monetary policy will be maintained for the time being by the BOJ, the JGB market remains steady. On the other hand, prices are rising due to the reactionary demand which has been suppressed by the global supply restraint and the COVID-19 pandemic. Since overseas interest rates are unstable from a sense of caution for a monetary tightening in response to this, we believe it necessary to pay attention to its effect on JGBs.

・ Despite the assumption of an early raising of interest rates by FRB, the Forward 1-month OIS curve between 2023 and 2025 has rather fallen possibly due to signs of adverse influences on the economy in the medium-to-long term in return for overcoming inflation. In other words, possibilities of an interest rate decrease have been slightly allowed for. In the circumstances, the increase of long-term interest rates is limited and as a result, the interest rates on 10-year JGBs and interest rates on 40-Year Bonds remain steady at around 0.05% and 0.70%, respectively.

However, there are many investors who foresee higher interest rates in the future and we believe that US interest rates will become higher in the process of the tapering progress and interest raising. Amid the expectation that the natural interest rates will fall, our company does not believe that interest rates will rise sharply and interest rates on 10-Year US bonds will peak at around 2%.

Under such circumstances, although we do not expect that the BOJ will shift into tightening the monetary policy, if the Japanese yen depreciates excessively and policy effects such as the lowering of the mobile phone tariffs are lost in CPI, we believe that the need to correct the excessive easing policy will be considered in the future. In particular, such a speculation may be justified in particular in the spring of 2023 onwards when the change of the Governor of the BOJ will take place.

We expect that the volatility will increase more than now, and if this occurs, the demand by overseas investors may increase and the average number of orders will also increase. Therefore, we request that the issuance size of the Non-Price Competitive Auctions I be increased.

・ There will be no change in the basic frame that "the yield curve control tightens the yield fluctuation band of JGBs with a remaining maturity of 10 years or less and a one-sided yield increase in ultra-long term bonds which are not under the influence of the BOJ will be avoided due to the time structure". Consumer prices of October in Japan (excluding fresh food and energy) were down 0.7%. When excluding the large impact of the reduction in mobile phone charges and the factors to push up prices of the reduction of impact of "Go To Travel", the CPI increased by 0.4% compared to the previous year. In addition, although many companies are continuing their efforts to not pass the upstream price increase on the downstream side, the upstream corporate goods prices in November increased by 9.0% compared to the previous year, a high increase since December 1980, and it has been reported recently that the prices of a variety of goods have increased. Although a certain precaution is needed compared to before, the understanding that "2% is far away" will not change significantly. Regarding the supply and demand for ultra-long-term bonds, while the buying on balance by life insurance companies (and non-life insurance companies) in August, September and October has increased, and the increase in the issuance size of 40-Year Bonds have been almost discounted, it can be said that the market is currently in a good position.

Incidentally, the inter-relation between the long-term interest rates in the US and in Japan continues to be constantly high, and thus, were are concerned about the direction of the US economy and the monetary policy of FRB. Price rises caused mainly by supply restrain is lasting longer than expected. The hawkish attitude of the FRB has become clear by moving forward the end of the tapering and securing freedom to choose the timing for staring to raise interest rates. However, the attitude of the FRB enhances concerns over stagflation in the market and the yield curve tends to flatten including some twists. If stagflation comes true, long-term interest rates will not rise. On the other hand, if the supply restraint is eliminated, the FRB will not be able to raise interest rates or the frequency thereof will be reduced to minimum and short-term interest rates will fall. Therefore, we expect that the peak of the US long-term interest rates will not be very high and our main scenario is that continuous simultaneous rise of the long-term interest rates in the US and in Japan will discontinue. Incidentally, we believe that when the US long-term interest rates are considered, what is concerned about may be not the rise in the expected inflation rate, but the rise in real interest rate which are significantly negative.

・ While the volatility of US bonds increases amid the risk off due to the COVID-19 "Omicron" variant, the speed of the tapering in the US and the speculation about the timing of interest raising, the JGB market remains stable. Although the JGB market will be affected to a certain extent by the price movements in overseas markets, we are of the view that as far as Outright Purchase of JGBs continue, the price movements in the JGB market will remain in the range.

・ There are not a few clients, mainly US investors, who participate in auctions because the auctions are conducted under the uniform price auction. When the auction system is shifted to the discriminatory auction system in conjunction with an increase in the issuance size of 40-Year Bonds, we believe that a considerably cautious judgment will be required because measures which will increase supply and decrease demand in the primary market are taken.

In addition, there are opinions that JGBs have been issued at higher prices than actual prices by the uniform price auction. We have no objection to the argument that such a thing occurs. However, when the frequency of the occurrence of such cases was checked, it occurred only once at the auction of JGBs in November when the price was fixed at higher prices than actual prices at the closing of the morning session in the four auctions from April onwards in which JGBs worth ¥600 billion were issued. In other three occasions, the prices were fixed at lower prices than actual prices at the closing of the morning session. As pointed out by a plurality of companies in the past meetings, we believe that the Dutch auction system contributed to the price stability by supplementing the lack of demand at the time of bidding.

Although we believe that the issue of the increase in JGBs should be addressed with an increase in the amount of Liquidity Enhancement Auctions of bonds with a remaining maturity of 15.5 to 39 years, if the majority of participants favor the increase in the amount of current 40-Year Bonds, we support the increase in 40-Year Bonds, but we oppose that the shift to the discriminatory price auction system be carried out simultaneously.

・ The JGB market continues to be linked to the movement of overseas interest rates.　Most recently, interest rates which fell globally due to threat caused by the apparition of a new COVID-19 variant have risen because the concerns slackened slightly. We assume that interest rates on JGBs will continue to fluctuate in view of the trends in global interest rates in the future.

・ We feel that the participation of relative value investors in the JGB market is decreasing because of a further decrease in liquidity of existing bonds. Although there are opinions that consider that this is inevitable because interest rates are controlled by YCC, it is obvious that the reduction in size of the secondary market is detrimental to the continuation of a large scale issuance of new JGBs. We believe it is time to review the management method of YCC by the BOJ which has been in place for over 5 years, including the shortening of maturities subject to interest rate control.

Contact:
Market Control Section, Market Finance Division,
Financial Bureau,
Ministry of Finance
03-3581-4111 (ext.5700)